

American Banker

The Daily Financial Services News

150222000015 2/ 5/07 C11
CONGRESSIONAL INFOR SREV SRI
ACQUIS EDITOR SRI
4520 E. WEST HIGHWAY
BETHESDA MD 20814

VOL. CLIII NO. 148

Monday, August 1, 1988

Today

NEWS MONDAY

Is the example of Mellon's 'bad bank' a dream come true for banks saddled with problem loans? Maybe not, writes Bart Fraust in his Perspective column. **11**

Lobbyists and regulators, journalists and congressional aides vied for seats in the hearing room last week to watch the action at the House Banking Committee's marathon session on industry-reform legislation. **13**

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INSIDE

The Federal Reserve Board was urged by executives of the parent companies of limited-service banks to set up a task force to revamp regulations governing the grandfathered nonbank banks. **3**

Hogan Systems Inc. suffered a bigger-than-expected loss in its June 30 quarter — \$5.9 million — and it laid off about 100 employees during the three months, a fifth of its work force. **8**

Federal regulators have put Pathway Financial, a large, financially ailing Chicago thrift, on the block. Bids are due early this month. **8**

Valley Federal Savings and Loan Association, recently the object of a hostile takeover attempt by Citadel Holding Corp., lost \$4.7 million in the second quarter. **15**

Despite the apparently glittering first-half profits turned in last week by the Big Four British banks, a minority of London bank analysts believe the engine that has been driving much of the banks' recent growth — domestic consumer banking — is slowly running out of steam. **16**

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COMMENT

While there is virtually no chance that the government will allow an agency that carries the name 'federal' — like the Federal Savings and Loan Insurance Corp. — to go under, keeping the FSLIC afloat will mean a major hit to the American taxpayer sooner or later, writes Dr. Paul S. Nadler. **4**

Worth Repeating

The bottom line is that for hundreds of credit unions and millions of their customers... share drafts will be treated as part of the local landscape.

Durant S. Abernethy 3d of the Credit Union National Association, on a ruling upholding the group's contention that a Federal Reserve regulation gives banks and thrifts an unfair advantage by treating credit union share drafts as nonlocal items when they are cleared through remote institutions. [Page 1]

AN AMERICAN BANKER SPECIAL REPORT

Top 25 Banks Eliminated 10% Of Third World Loans in a Year

By BART FRAUST

NEW YORK — The nation's 25 largest bank holding companies have slashed their Third World loan portfolios by about one-tenth since establishing massive reserves for these credits in June 1987, according to a survey by the *American Banker*.

But about \$5 of every \$100 in assets at these companies is Third World debt. And the amounts are expected to tick upward in the coming months as a new \$5.2 billion loan package for Brazil nears completion and as Argentina, Venezuela, and other countries seek new loans.

The 10 biggest banking companies, those holding the bulk of Third World loans, have cut their debt by an average of 7.8% since June 30, 1987. The banks ranked 11 through 25, mostly

Special Report: Page 2 ➡

Third World Debt

Top 25 bank companies
(comparisons on June 30)

Percent of assets	1988	1987
Total	4.9%	5.7%
Numbers 1-10	6.3	7.0
Numbers 11-25	2.4	3.2

Multiple to common shareholders' equity

Total	1.1	1.4
Numbers 1-10	1.5	2.0
Numbers 11-25	0.5	0.6

Multiple to total reserves

Total	2.0	2.3
Numbers 1-10	2.5	2.6
Numbers 11-25	1.1	1.6

Home Loan Banks Spurn FSLIC Notes

By JIM McTAGUE
Washington Bureau

WASHINGTON — Eleven of the nation's 12 Federal Home Loan banks are resisting pressure to make cash advances on uncollateralized notes issued by the insolvent Federal Savings and Loan Insurance Corp., industry and regulatory sources say.

M. Danny Wall, chairman of the Federal Home Loan Bank Board, pitched the notes at a meeting last week in Baltimore, some attendees reported.

Mr. Wall said Friday that the reports are wrong. "I haven't made a pitch and there isn't any resistance," he said.

The FSLIC is guaranteeing full re-

payment of the notes. They have been used by the cash-strapped agency to assist investors buying insolvent thrifts, especially in Texas.

So far, only the Federal Home Loan Bank of Dallas has accepted the guarantees. As a result, it has yet to receive an opinion from its auditor for 1987.

In 1986, auditors of the Dallas bank gave it a qualified opinion because they were concerned about the credit quality of the notes. The FSLIC was forced to redeem the notes with cash.

The auditor — Deloitte, Haskins & Home Loan: Page 15 ➡

Credit Unions Win Court Fight On Check Holds

New Fed Regulations Found Discriminatory

By YVETTE D. KANTROW

NEW YORK — A federal court has ruled that Federal Reserve Board regulations on check processing discriminate against credit unions. The decision effectively requires banks to treat local credit union share drafts as local checks, even if the draft is drawn on an out-of-town bank.

The ruling is a victory for the Credit Union National Association, which sued the Fed in May over a portion of Regulation CC, the new rules that limit the holds banks place on checks. In a decision filed late Thursday, the U.S. District Court for the District of Columbia upheld the association's contention that the Fed gives banks and thrifts an unfair advantage by treating credit union share drafts as nonlocal items when they are cleared through remote institutions.

The court also held that the regulation violates the "clear and unambiguous" language of the law that mandates it.

The credit union group lauded the court's decision. "The bottom line is that for hundreds of credit unions and millions of their customers... share drafts will be treated as part of the local landscape," said Durant S. Abernethy 3d, senior vice president and general counsel for the Credit Union National Association.

The Fed adopted Regulation CC in May to implement the Expedited Funds Availability Act, which Congress passed in 1987. The act requires

Credit Unions: Page 6 ➡

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Top 25 Bank Companies Sharply Reduce Exposure to Third World

Continued from Page 1

superregionals, have pared their Third World loans by 24%, about triple the rate of the top 10.

No bank among the top 25 increased its Third World debt during the period.

"This confirms the across-the-board decision by U.S. banks to exit from their exposures," said Paul Sachs, president of Multinational Strategies Inc., a New York-based consulting firm.

Besides declining in terms of total dollars, Third World debt declined in relation to total assets, common equity, and loan-loss reserves, the survey found. But Third World debt continues to be greater than either common stockholders' equity or total loan-loss reserves.

James J. McDermott, executive vice president of Keefe, Bruyette & Woods Inc., said the decisions last year to establish special reserves were intended to give banks flexibility in dealing with Third World debt. "The reductions in exposure show the process is well under way," he said.

The cutbacks come at a time of increased optimism about Third World debt in general, mainly sparked by an improved outlook for Brazil. The world's largest bank debtor has ended its debt moratorium and resumed interest payments. The country recently signed a preliminary agreement with its major lenders to reschedule \$61 billion in existing debt and to obtain \$5.2 billion in new loans.

"This has been a good year, with no major adverse events," Mr. Sachs said.

Political Problems Lurk

The debt crisis, which began in 1982, may heat up again next year. Argentine President Raul Alfonsin, in anticipation of upcoming presidential elections and Peronist pressure to declare a debt moratorium, has taken a more belligerent position in seeking renegotiation of its loans. Mexico's new administration may take a less conciliatory stand on its bank debt. And Venezuela, Latin America's most reliable debtor nation, has been battered by weak oil prices and is seeking renegotiation of its loan terms.

The nation's 25 largest banking companies now hold about \$65 billion in loans to Third World countries, down 10.8% from June 30, 1987. The 10 largest banking companies hold 80% of this debt.

The data for the survey was obtained directly from the banking companies in most cases. For banks that declined to disclose their Third World exposures, data were obtained from the most recent quarterly financial statements filed with the Securities and Exchange Commission.

Third World debt specialists said the banks have reduced the debt through a variety of techniques, including exchanging the loans for equity positions in companies in the Third World, paying down the principal on the loans, and charging off credits.

In addition, banks are finding it easier to sell their debt into the secondary market. Mr. Sachs said market volume may go as high as \$20 billion this year, about double the 1987 pace.

For example, Security Pacific Corp. sold \$500 million of its Third World debt into the secondary market in the first half of 1988, according to its second-quarter earnings report. Continental Illinois Corp. said it reduced its Third World debt by \$250 million through debt sales and swaps.

Citicorp, which led the move to create special reserves last year, has been the most aggressive of the top 25 in getting rid of Third World debt. According to its second-quarter earnings report, the corporation has sliced \$2 billion off its Third World debt since

last June. It now totals \$12.6 billion, compared with \$14.6 billion at year-end. Citicorp has said that 80% of the cutback came from full repayment of loans or from loan sales at relatively thin discounts of 10% to 30% of the credits' face values.

Bank of Boston Corp., with an \$846 million reduction, had the second biggest dollar drop. "Our policy is to put the LDC debt problem behind us," said Alan L. McKinnon, executive vice president and treasurer of Bank of Boston.

J.P. Morgan & Co. reduced its Third World debt by \$600 million. About \$200 million of the cutback resulted from the Mexican bond program that Morgan championed. Under the plan, banks exchanged Mexican loans at a discount for Mexican bonds, the principal of which is collateralized by zero coupon U.S. Treasury bonds.

Wells Fargo & Co., with a 31.6% drop in exposure, had the biggest percentage decline among the top 10.

First Union Sheds All LDC Debt

Among the top 25 banks, First Union Corp. had the sharpest percentage decline, completely eliminating its \$59 million of Third World debt. NCNB cut \$239 million, resulting in a Third World loan portfolio of a mere \$8 million. Other big drops were shown by the Fleet/Norstar Financial Group and SunTrust Banks Inc.

Despite the reductions, Third World debt continues to represent a sizable portion of bank assets.

On average, Third World debt comprised 4.9% of assets for the 25 largest bank companies, compared with 5.7% at June 30, 1987. The 10 largest banking companies cut their exposures to 6.3% of assets from 7% last year. Banks in the second tier reduced their position to 2.4% of assets from 3.2%.

Manufacturers Hanover Corp. and BankAmerica Corp. continue to have the greatest Third World exposure in relation to assets. At each corporation, about \$10 of every \$100 of assets consists of Third World debt. Citicorp cut its exposure to 6.1% from 7.5%, Morgan to 5.9% from 7.2%, Security Pacific to 1.9% from 3%, and Wells Fargo to 2.8% from 4.3%.

Analysts cautioned that the asset ratio could increase over the next few years if banks continue to shrink assets without making corresponding decreases in Third World debt.

Decline Relative to Equity

The banks have also cut their exposures relative to common equity. For the top 25, loans to lesser-developed countries were 1.1 times average common equity, compared with 1.4 times equity last year. For the 10 largest banks, Third World debt dropped to 1.5 times equity from twice equity last year. For the second tier, the multiple dropped to 50% of equity from 61%.

This multiple is expected to improve greatly over the next few years, as banks increase equity in anticipation of new international capital guidelines scheduled to take effect in 1992.

Manufacturers Hanover, at 3.4, and BankAmerica, at 2.5, again showed the weakest multiples. But both companies have been aggressively raising equity in recent months, and both showed substantial improvement from a year ago. At that time, Manufacturers' multiple was 4.5, and BankAmerica's was 3.1.

Third World debt at the 25 largest bank companies fell to twice total reserves from 2.3 times reserves last year. For the 10 largest, the multiple fell to 2.5 times reserves from 2.6 in June 1987. For banks ranked 11 through 25, it fell to 1.1 from 1.6.

Banks Cut Third World Loans

Loans on June 30, unless otherwise indicated¹ (dollar amounts in millions)

	1988	1987	% Chg.
1 Citicorp, New York	\$12,600	\$14,600	-13.7%
2 Chase Manhattan Corp., New York ²	6,400	6,400	0
3 BankAmerica Corp., New York	9,100	9,200	-1.1
4 J.P. Morgan & Co., New York	4,800	5,400	-11.1
5 Chemical Banking Corp., New York	5,900	5,900	0
6 Security Pacific Corp., Los Angeles	1,400	2,200	-36.4
7 Manufacturers Hanover Corp., New York ²	7,500	7,600	-1.3
8 First Interstate Bancorp, Los Angeles	1,240	1,606	-22.8
9 Bankers Trust New York Corp. ²	4,000	4,000	0
10 Wells Fargo & Co., San Francisco	1,300	1,900	-31.6
11 First Chicago Corp.	2,500	3,000	-16.7
12 PNC Financial Corp., Pittsburgh	352	504	-30.2
13 Bank of Boston Corp.	760	1,606	-52.7
14 Continental Illinois Corp., Chicago	1,700	2,400	-29.2
15 Mellon Bank Corp., Pittsburgh	1,310	1,600	-18.1
16 First Fidelity Bancorp., Newark/Philadelphia	181	250	-27.4
17 Bank of New England Corp., Boston	296	302	-2.0
18 NCNB Corp., Charlotte, N.C.	8	247	-96.8
19 First Union Corp., Charlotte, N.C.	0	59	-100.0
20 SunTrust Banks Inc., Atlanta	49	131	-62.6
21 Shawmut National Corp., Hartford, Conn.	270	288	-6.3
22 Marine Midland Banks Inc., New York ²	1,700	1,700	0
23 First RepublicBank Corp., Dallas ²	1,300	1,400	-7.1
24 First Bank System Inc., Minneapolis	284	510	-44.3
25 Fleet/Norstar Financial Group, Providence, R.I.	52	145	-64.2
Top 25 Banks	65,000	72,900	-10.8
Top 10 Banks	54,200	58,800	-7.8
Banks 11-25	10,800	14,100	-23.8

¹ This survey sought out total loan exposure to Third World countries as reported by the bank holding companies to the Securities and Exchange Commission. In most cases, the numbers were provided by the bank holding companies. For others, SEC documents were used. Bank reporting practices differ greatly. Chase Manhattan, for example, in the past has disclosed exposure to Brazil, Mexico, Argentina, Venezuela, and Chile. Others report exposure to 31 countries that have sought to refinance their bank loans in the past few years. Still others do not break out Third World loans in their SEC reports.

² Declined to provide June 30, 1988, data before release of quarterly financial reports. Data for 1988 are as of March 31 and were obtained from first-quarter reports on file with SEC. 1987 data are from June 30 and public SEC filings.

1988 Chargeoffs for Third World Debt

First six months (dollar amounts in millions)

	Net Chargeoffs	% of Exposure
1 Citicorp, New York	\$155	1.2%
2 Chase Manhattan Corp., New York	178	2.8
3 BankAmerica Corp., New York	N.A.	N.A.
4 J.P. Morgan & Co., New York ¹	204	4.3
5 Chemical Banking Corp., New York	31	0.5
6 Security Pacific Corp., Los Angeles	348	25.0
7 Manufacturers Hanover Corp., New York	69	0.9
8 First Interstate Bancorp, Los Angeles ²	132	10.6
9 Bankers Trust New York Corp.	N.A.	N.A.
10 Wells Fargo & Co., San Francisco	102	7.9
11 First Chicago Corp.	182	7.3
12 PNC Financial Corp., Pittsburgh	36	10.2
13 Bank of Boston Corp.	35	4.6
14 Continental Illinois Corp., Chicago	25	1.5
15 Mellon Bank Corp., Pittsburgh	11	0.8
16 First Fidelity Bancorp., Newark/Philadelphia	N.A.	N.A.
17 Bank of New England Corp., Boston	N.A.	N.A.
18 NCNB Corp., Charlotte, N.C.	48	600.0
19 First Union Corp., Charlotte, N.C. ³	29	N.A.
20 SunTrust Banks Inc., Atlanta	29	53.2
21 Shawmut National Corp., Hartford, Conn.	7	2.6
22 Marine Midland Banks Inc., New York	N.A.	N.A.
23 First RepublicBank Corp., Dallas	N.A.	N.A.
24 First Bank System Inc., Minneapolis	27	9.5
25 Fleet/Norstar Financial Group, Providence, R.I.	N.A.	N.A.
Top 25 Banks	1,647	3.3
Top 10 Banks	1,219	2.9
Banks 11-25	428	5.0

¹ Morgan's figures include approximately \$200 million in charge-downs related to its participation in the Mexican program in which it and other banks exchanged Mexican loans at a discount for bonds.

² First Interstate's figures include all foreign chargeoffs.

³ First Union has no Third World exposure.

Over the last year, however, banks have allocated a portion of their reserves specifically to cover potential losses on Third World debt, and these special reserves have been rising

sharply at many banks. For example, Mr. McKinnon of Bank of Boston said three-quarters of his company's Third World loans are now covered by reserves.

What Do All These Thrift Failures Mean, Anyway?

By DR. PAUL S. NADLER

YOU talked about all the savings and loans in trouble. Does this mean we are going to have a giant series of bank failures like in the early 1930s?"

Hearing this question raised by an acute student after my Tuesday night class last month, I started to think and ask about what S&Ls' problems mean to various groups in our nation. I thought some of the answers that developed might be worth sharing.

First, there is the question of what the problems of thrifts in difficulty mean to top officials of thrifts that are not in trouble. The answer: precious little.

As a board member of a billion-dollar savings and loan put it to me:

"The only way it affects us is when the FSLIC raises our assessments. Otherwise, our depositors look only at the safety of FSLIC insurance, and they remain happy."

One could question, however, whether this confidence in the Federal Savings and Loan Insurance Corp. may be shaken in time.

Certainly most observers of the

Dr. Nadler is a professor of finance at Rutgers University's Graduate School of Management and is contributing editor of the *American Banker*.

American Banker

The Daily Financial Services Newspaper

Established 1836

One State Street Plaza, New York, N.Y. 10004
(212) 943-6700

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Classified: (800) 221-1910

International: (212) 943-4250

Telex: 421768 ABKR

Subscription Rates: U.S. \$525.00, Canada

\$775.00.

Canada Air Mail and Foreign \$1090.00. Single

copy \$3.45

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U.S. Patent and Trademark Office.

Published daily except Saturday, Sunday and

holidays.

Second Class Postage Paid at New York, N.Y. and at

additional mailing offices in U.S.A. (ISSN No.

0002-7561)

Postmaster: Send address changes to American

Banker, 1 State Street Plaza, New York, N.Y.

10004

For subscription orders and inquiries call:

Outside New York - (800) 221-1809

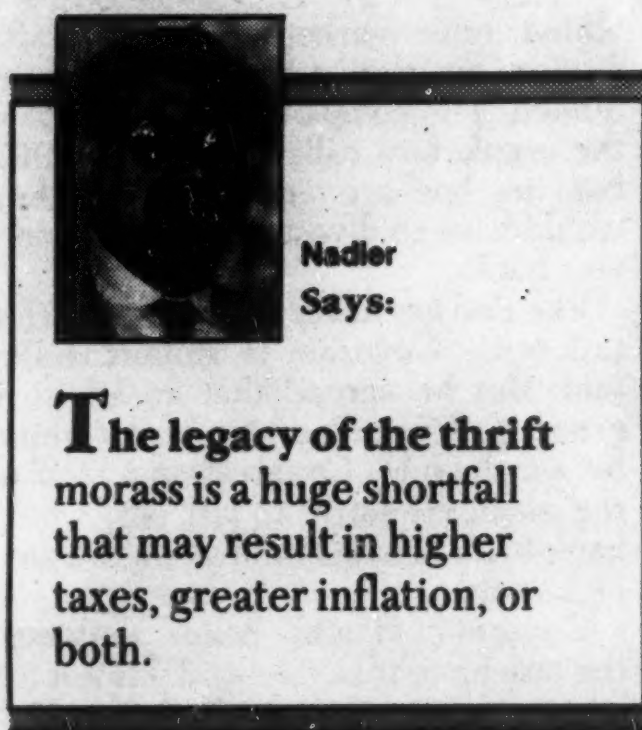
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Nadler
Says:

The legacy of the thrift morass is a huge shortfall that may result in higher taxes, greater inflation, or both.

banking scene, including myself, feel that even though the FSLIC has far too few resources to cover the estimated \$50 billion to \$80 billion that might be needed to bail out the nation's ailing thrifts, Congress will allow the Treasury to borrow enough money to do the job. In fact, we have already had resolutions stating that the federal government will cover FSLIC's obligations.

And if we know anything at all about finance, it is that the Federal Reserve has the power to create unlimited money if it is needed, and the Treasury must borrow by selling securities to the Fed.

While many observers feel this Treasury borrowing could proceed and depositors in ailing thrifts could be duly paid off, there are others who are not so sanguine.

Avoiding Tie-Ups in Weak S&Ls

Donoghue's *Money Letter*, for example, suggests in its July issue that people with money in weak savings and loans move it now into solid money market mutual funds. The newsletter holds that there is no assurance that the money will be made available to FSLIC just when it needs it, so a serious liquidity problem could arise when people with money in weak S&Ls find it impossible to get their funds out without a long delay.

The Donoghue newsletter reminded its readers that some people with money in weaker Maryland savings institutions that had state insurance instead of federal protection still have not received their money, more than three years after the first of the thrifts collapsed. It asks: "Why take a chance? Why not get your money out of weaker institutions now?"

(As for determining which are the weak ones, it will sell you an evaluation of those that interest you for a modest fee.)

But at least in my opinion, Bill Donoghue is too pessimistic this time around. There is virtually no chance that the government will allow an organization that carries the name "federal" to go under — or even delay payment and leave the public empty-handed for a short time. If FSLIC needs \$50 billion, it will get it. If it needs \$80 billion, it will get it. And immediately. The depositors will not be hurt.

But where will this money come from? Will it come from higher taxes?

Something to Say?

Please direct any comments you may have to the editor, William Zimmerman, American Banker, One State Street Plaza, New York 10004. Letters may be edited for reasons of space and clarity.

Raising \$80 billion through taxes would require levying the equivalent of a \$900 tax on every household in the nation. With an election campaign in which neither side has been willing to talk about tax increases to solve the present deficits, much less to raise \$80 billion to bail out weak thrifts, it would seem impossible to create the new money without triggering major inflation.

Inflation helps avoid serious collapse in property values, and a serious collapse in property values helps avoid inflation. We don't get the worst in both.

But be this as it may, borrowing \$50 billion to \$80 billion just means that taxpayers pay the bill later rather than sooner. It still involves a major hit to the American taxpayer.

Where Did the Money Go?

What did we get for our potential tax of \$900 per household? After all, the money has to have gone somewhere. It did not just disappear.

Some of it, unfortunately, is lining the pockets of entrepreneurs who used their savings and loans as private lending organizations for their own projects. Brokered deposits have provided ample resources to lend to themselves, and laws have been moderated to allow investment in a vast array of projects that have little to do with the traditional thrift role of financing America's homes. Little wonder these entrepreneurs looked at the thrifts they ran as geese that laid golden eggs.

Their motto was, "Heads I win, tails the FSLIC and the taxpayers lose." They have obtained a lot of the billions we are talking about.

Most of the rest went into financing projects that should never have been financed, judging by their inability to earn a decent return for the thrifts that lent to them. When Houston has more empty office space than Boston has total office space, one can question where the money for this surplus space came from. If you want an answer, you will be reminded every April 15, when you send your love letter to the Internal Revenue Service.

In essence, it is like the Real Estate Investment Trust era. When the REITs thrived, money was made so readily available to them that they made loans that should not have been made, just to use the money.

It is also like the petrodollar era. The oil exporters put so much money in U.S. banks that these banks made unsound Third World loans just to use the deposits they had on hand.

And now, the thrifts have gotten money so easily and painlessly that they have financed projects that America won't need for years, if ever. The only difference is that when the REITs got into trouble, it was their shareholders who paid. When the banks got into trouble, it was their shareholders who paid. But with today's thrift problem, it looks as if the entire American economy will have to pay — either through higher taxes or more inflation, or both.

It is hard to think that any new administration will be able to look at the consequences of thrift deregulation without pushing for new legislation. Unfortunately this new legislation may affect the freedom of all financial institutions — both those that were involved in these difficulties and those that were innocent bystanders.

H. Erich Heinemann is on vacation. His column, *Overview*, will resume on Aug. 15.

MEMORY BANK

The following quiz is based on material that appeared in last week's issues of the *American Banker*. Answers are on page 6.

1. By any standard measure of profitability, this \$4.3 billion-asset company is by far the most profitable bank in England, if not in the industrialized world. In 1987, it posted a 39% return on shareholders equity and a 4% return on assets. At year-end 1987, it had a ratio of capital to risk-weighted assets of 13% and no exposure to Third World debt. The bank's biggest problem — most U.S. banks would love to have such problems — is finding suitable ways to use its accumulated capital, since it generates far more in deposits than it can possibly lend out. Identify this institution.



2. In the *American Banker's* 1987 ranking of top banks, ..., the world's 612th largest company, earned the dubious distinction of suffering the greatest decline in assets — 64.8%. Coincidentally, the reason given for this decline was the 64.8% fall in the value of the British pound relative to the dollar.

3. Indecorp, parent of the \$106 million-asset Independence Bank of Chicago, signed a definitive agreement to acquire Drexel Holding Co., parent of the \$113 million-asset Drexel National Bank. The merger will almost double Indecorp's assets to \$230 million, creating the largest bank in the nation.

4. A task force of the Electronic Funds Transfer Association found that one factor stunting the growth of point-of-sale payment systems is a lack of information about technical standards. On the consumer side, what other factor did the task force find working against promotions that use the term "debit card"?

5. In the first steps toward enacting comprehensive banking legislation, the House Banking Committee sat in marathon session until 2:30 a.m. Thursday — hammering out a series of amendments that generally expand the securities powers of commercial banks. A provision that took industry observers by surprise, however, was the amendment by Rep. Stephen L. Neal, D-N.C. How does this amendment affect the top 15 U.S. banks and the top 15 securities firms, along with any foreign financial firm with assets greater than \$30 billion?

6. Empire of America Federal Savings Bank, Buffalo, will soon begin test-marketing a Visa affinity credit card in the Los Angeles area. Individuals targeted in the test program by



Empire's California thrift division include theater patrons and residents of selected neighborhoods with high disposable incomes such as Beverly Hills, Brentwood, and West



Credit Cards

Hollywood. What national research foundation will receive \$5 of every \$25 membership fee and one-fourth cent of every dollar charged to this affinity account?

— Robert Paul Molay